

("NASD") submitted to the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change to amend its Rule 2860(b) to provide a delta hedging exemption from stock option position limits for OTC Derivatives Dealers affiliated with NASD member firms when certain conditions are satisfied.³ The Commission published the proposed rule change for comment in the **Federal Register** on October 21, 2004.⁴ The Commission received no comments on the proposed rule change.

Under the proposal, a stock option position of an OTC Derivatives Dealer that is delta neutral⁵ would be exempt from position limits, provided that, among other things, the NASD member with which the OTC Derivatives Dealer is affiliated has received a written representation from the OTC Derivatives Dealer stating that it is hedging its stock options positions in accordance with its internal risk management control and pricing models approved by the Commission. Any stock options position of an OTC Derivatives Dealer that is not delta neutral would remain subject to position limits.⁶

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder that are applicable to a national securities association.⁷ In particular, the Commission believes that the proposed rule change is consistent with Section 15A(b)(6) of the Act,⁸ which requires,

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The proposal relates to options positions of an "OTC Derivatives Dealer" as that term is defined in Rule 3b-12 under the Act. See 17 CFR 240.3b-12.

⁴ Securities Exchange Act Release No. 50539 (October 14, 2004), 69 FR 61884 (October 21, 2004).

⁵ The term "delta neutral" as defined in the proposed rule change describes a stock options position that has been hedged, in accordance with a Commission-approved pricing model, with a portfolio of instruments relating to the same underlying stock to offset the risk that the value of the options position will change with changes in the price of the stock underlying the options position.

⁶ See proposed NASD Rule 2860(b)(3)(A)(vii)(b)(3). The Commission notes that NASD Rule 2860(b)(3)(A)(vii) provides for multiple, independent hedge exemptions. Of course, to the extent that a position is used to hedge for the purpose of one exemption from position limit requirements, such as the delta hedge exemption, such position cannot be used to take advantage of another exemption from position limit requirements.

⁷ In approving this rule, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

⁸ 15 U.S.C. 78o-3(b)(6).

among other things, that NASD rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. The Commission has previously stated its support for recognizing options positions hedged on a delta neutral basis as properly exempted from position limits.⁹

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹⁰ that the proposed rule change (SR-NASD-2004-153) be, and it hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹¹

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50753; File No. SR-NASD-2004-147]

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Granting Approval to Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 1 To Modify the Bid Price Compliance Periods on the Nasdaq National Market and SmallCap Market and To Require Non-Canadian Foreign Issuers To Satisfy the Bid Price and Market Value of Publicly Held Shares Requirements Applicable to Domestic Issuers for Continued Listing on the SmallCap Market

November 29, 2004.

I. Introduction

On October 1, 2004, the National Association of Securities Dealers, Inc. ("NASD"), through its subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("Commission") pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² a proposed rule change to modify the bid price

⁹ Securities Exchange Act Release No. 40594 (October 23, 1998), 63 FR 59362, 59380 (November 3, 1998) (adopting rules relating to OTC Derivatives Dealers).

¹⁰ 15 U.S.C. 78s(b)(2).

¹¹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

compliance periods on the Nasdaq National Market and the Nasdaq SmallCap Market and to require non-Canadian foreign issuers to satisfy the minimum bid price and market value of publicly held shares requirements applicable to domestic issuers for continued listing on the Nasdaq SmallCap Market. The proposed rule change was published for notice and comment in the **Federal Register** on October 21, 2004.³ The Commission received no comments on the proposal. On November 24, 2004, Nasdaq filed Amendment No. 1.⁴ This order approves the proposed rule change. Simultaneously, the Commission provides notice of filing of Amendment No. 1 and grants accelerated approval of Amendment No. 1.

II. Description of the Proposal

A. Modification of the Bid Price Compliance Periods

Nasdaq rules relating to the minimum bid price requirement were approved on a pilot basis by the Commission in February 2002⁵ and modified in March 2003⁶ and December 2003.⁷ The pilot, which expires on December 31, 2004, provides 180 calendar days for a National Market issuer trading below \$1.00 to regain compliance. Upon the expiration of the first 180 calendar days, an issuer able to satisfy all initial listing criteria is eligible for an additional grace period of another 180 calendar days. Thereafter, a National Market issuer may phase down to the SmallCap Market to take advantage of an additional grace period if it meets all SmallCap initial listing criteria except for bid price.⁸ If a National Market issuer is not in compliance 45 days before the expiration of its second grace period, Nasdaq would send a warning letter to the issuer and the issuer could request a hearing at that time, if one were desired.

The current pilot also provides 180 calendar days for a SmallCap Market issuer to regain compliance. Upon the expiration of the first 180-day grace period, an issuer satisfying all initial

³ See Securities Exchange Act Release No. 50541 (October 14, 2004), 69 FR 61888.

⁴ In Amendment No. 1, Nasdaq made a technical correction to the text of NASD Rule 4450(i)(1).

⁵ See Securities Exchange Act Release No. 45387 (February 4, 2002), 67 FR 6306 (February 11, 2002) (SR-NASD-2002-13).

⁶ See Securities Exchange Act Release No. 47482 (March 11, 2003), 68 FR 12729 (March 17, 2003) (SR-NASD-2003-34).

⁷ See Securities Exchange Act Release No. 48991 (December 23, 2003), 68 FR 75677 (December 31, 2003) (SR-NASD-2003-44), amended by Securities Exchange Act Release No. 48991A (February 5, 2004), 69 FR 6707 (February 11, 2004).

⁸ See *infra* Section III.

listing criteria for the SmallCap Market is eligible for an additional grace period of 180 days. Thereafter, an issuer can receive a third grace period, up to the time of its next shareholders meeting (but not more than two years from the original notice of deficiency), if the issuer seeks shareholder approval for a reverse stock split at that meeting and implements the reverse stock split promptly afterward.

Having reviewed its experience with the pilot program, Nasdaq proposes to modify the bid price rules and seeks permanent Commission approval of the revised rules. Under the proposal, a National Market issuer would now have 180 days to regain compliance on the National Market, after which it could transfer to the SmallCap Market if it complied with all SmallCap initial inclusion requirements except for bid price.⁹ The new rules would provide a SmallCap issuer with an initial 180-calendar-day period to regain compliance. Thereafter, the issuer could receive a second 180-day grace period if it complied with all initial SmallCap inclusion requirements except for bid price. The third grace period under the pilot rules, which allows a SmallCap issuer to remain listed while it seeks shareholder approval of a reverse stock split, would be eliminated. An issuer in a compliance period under the pilot rules at the time the new rules become effective would be able to finish that period, but thereafter could only use grace periods afforded by the new rules.

B. Nasdaq SmallCap Market Continued Listing Requirements for non-Canadian Foreign Issuers

Nasdaq proposes to amend NASD Rule 4320 to require non-Canadian foreign issuers to satisfy the minimum bid price and market value of publicly held shares requirements applicable to domestic issuers for continued listing on the SmallCap Market. Currently no such continued listing requirements apply to SmallCap non-Canadian foreign issuers.¹⁰ To allow these issuers sufficient time to take any necessary action to achieve compliance, Nasdaq proposes that this requirement be effective 18 months after approval by the Commission.

III. Amendment No. 1

In Amendment No. 1 Nasdaq modified the text of NASD Rule 4450(i)(1) to provide that a National Market issuer deemed not in compliance prior to the expiration of the compliance period for bid price may transfer to SmallCap Market if it meets all applicable requirements for initial inclusion on the SmallCap Market. The prior text of the rule referred to requirements for "continued" rather than "initial" inclusion.

According to Nasdaq, Amendment No. 1 corrects an inconsistency in both the existing and proposed rule concerning the appropriate standard pursuant to which an issuer may transfer between the Nasdaq National Market and the SmallCap Market. This inconsistency first arose following the approval of SR-NASD-2003-44.¹¹ In SR-NASD-2003-44, Nasdaq proposed that a SmallCap issuer must meet all initial inclusion requirements for the SmallCap Market to be eligible for an additional compliance period.¹² As such, an issuer that transferred from the National Market would not be eligible for an additional compliance period on the SmallCap Market unless it met all SmallCap initial inclusion standards.

In addition, NASD Rules 4310(c)(8)(D) and 4320(e)(2)(E)(ii) would permit an issuer to qualify for a second 180-day compliance period on the SmallCap Market only if that issuer met all criteria for initial inclusion (except for the bid price requirement) on the SmallCap Market. Thus, even if an issuer were permitted to transfer to the SmallCap Market based on the continued inclusion criteria at the end of its compliance period on the National Market, the issuer would be subject to immediate delisting because it would be ineligible for any additional compliance periods with respect to its bid price deficiency.

The text of NASD Rule 4450(i)(1) as Nasdaq is proposing to amend it is below. New text is in *italics* and deletions are in *brackets*.

If a National Market issuer has not been deemed in compliance prior to the expiration of [a] *the* compliance period for bid price *provided in Rule 4450(e)(2)*, it may transfer to The Nasdaq SmallCap Market, provided

that it meets all applicable requirements for [continued] *initial* inclusion on the SmallCap Market set forth in Rule 4310(c) [(other than the minimum bid price requirement of Rule 4310(c)(4))] or Rule 4320(e), as applicable, *other than the minimum bid price requirement*. A Nasdaq National Market issuer transferring to The Nasdaq SmallCap Market must pay the entry fee set forth in Rule 4520(a). The issuer may also request a hearing to remain on The Nasdaq National Market pursuant to the Rule 4800 Series.

IV. Discussion and Commission Findings

The Commission has reviewed carefully the proposed rule change, as amended, and finds that it is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.¹³ In particular, the Commission believes that the proposal is consistent with Section 15A(b)(6) of the Act,¹⁴ which requires that an association's rules be designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, remove impediments to, and perfect the mechanism of, a free and open market and, in general, protect investors and the public interest.

The Commission believes that a 180-day grace period for bid price compliance on the Nasdaq National Market and a 360-day grace compliance period on the SmallCap Market will allow a reasonable period for issuers to regain compliance with the bid price rules before being subject to delisting. These time frames are generally consistent with bid price compliance periods available on other markets that have been approved by the Commission.¹⁵ The Commission also believes that requiring non-Canadian foreign issuers to satisfy the same continued listing standards for minimum bid price and market value of publicly held shares applicable to domestic issuers is reasonable and will establish consistent standards applicable to all SmallCap issuers.

The Commission finds good cause for approving proposed Amendment No. 1 before the 30th day after the date of publication of notice of filing thereof in the **Federal Register**. NASD Rule

⁹ See NASD Rule 4450(i). See also *infra* Section III.

¹⁰ A rule change to impose such requirements for initial listing by non-Canadian foreign issuers was approved in September 2004. Under this change, all non-Canadian foreign issuers are required to meet the same initial inclusion bid price and market value of publicly held shares requirements as domestic and Canadian issuers. See Securities Exchange Act Release No. 50458 (September 28, 2004), 69 FR 59286 (October 4, 2004).

¹¹ Securities Exchange Act Release No. 48991 (December 23, 2003), 68 FR 75677 (December 31, 2003).

¹² Prior to approval of this rule change, issuers listed on the SmallCap Market (including those that transfer from the Nasdaq National Market) were eligible for an additional compliance period based on meeting only the core initial inclusion requirements contained in NASD Rule 4310(c)(2)(A) and the remaining continued inclusion requirements for the SmallCap Market.

¹³ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹⁴ 15 U.S.C. 78o-3(b)(6).

¹⁵ See, e.g., NYSE Listed Company Manual, Rule 802.01C (Price Criteria for Capital or Common Stock); Securities Exchange Act Release No. 42194 (December 1, 1999), 64 FR 69311 (December 10, 1999) (SR-NYSE-99-29); Securities Exchange Act Release No. 44481 (June 27, 2001), 66 FR 35303 (July 3, 2001) (SR-NYSE-2001-02).

4450(i)(1) currently states that a National Market issuer deemed not in compliance prior to the expiration of the compliance period may transfer to the SmallCap Market if it meets all applicable requirements for continued inclusion on the SmallCap Market. Nasdaq contends that use of the word "continued" in Rule 4450(i)(1) is inadvertent and has provided evidence that the rule language instead should have used the word "initial" from its inception. The Commission agrees and finds good cause for accelerating approval of Amendment No. 1, thereby allowing the text of NASD Rule 4450(i)(1) to mirror the original intent of the rule without delay.

V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 1, including whether Amendment No. 1 is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASD-2004-147 on the subject line.

Paper Comments

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609.

All submissions should refer to File Number SR-NASD-2004-147. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to Amendment No. 1 between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal

office of the NASD. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD-2004-147 and should be submitted on or before December 27, 2004.

VI. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹⁶ that the proposed rule change (File No. SR-NASD-2004-147) be, and it hereby is, approved, and that Amendment No. 1 to the proposed rule change be, and hereby is, approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁷

Jill M. Peterson,

Assistant Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50742; File No. SR-PCX-2004-101]

Self-Regulatory Organizations; Pacific Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 Thereto To Add a \$500 Application Fee for Waivers of Exchange Examination Requirements Pursuant to PCX Rule 2.5(c)(4)

November 29, 2004.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on October 18, 2004, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II and III below, which Items have been prepared by the Exchange. On November 23, 2004, PCX amended the proposed rule change.³ The PCX has designated this proposal as one changing a fee imposed by the PCX under Section 19(b)(3)(A)(ii) of the Act⁴ and Rule 19b-4(f)(2) thereunder,⁵ which renders the proposal

effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The PCX proposes to amend its Schedule of Fees and Charges For Exchange Services to add a \$500 application fee for waivers of Exchange examination requirements pursuant to PCX Rule 2.5(c)(4). The text of the proposed rule change is available at the PCX and at the Commission.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the PCX included statements concerning the purpose of and basis for its proposal and discussed any comments it received regarding the proposal. The text of these statements may be examined at the places specified in Item IV below. The PCX has prepared summaries, set forth in Sections A, B and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The PCX is proposing to implement a non-refundable application fee of \$500 when a request to waive an Exchange examination requirement is submitted pursuant to PCX Rule 2.5(c)(4). Since the Commission approved PCX Rule 2.5(c)(4),⁶ the Exchange has received a number of requests for waivers of its examination requirements.

When a request is submitted to the Exchange, the Exchange's Shareholder and Registration Services Department ("SRS") evaluates each application. SRS must independently verify each statement made in the application to ensure that waivers are only granted to those who are properly qualified. Applicants requesting waivers have based their requests on numerous factors including employment history, education, professional licenses held, examinations passed, etc. Depending on the type of justification given and how recently such justification occurred, the amount of time needed to independently verify each individual

¹⁶ 15 U.S.C. 78s(b)(2).

¹⁷ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Amendment No. 1 replaced and superseded the original filing in its entirety.

⁴ 15 U.S.C. 78s(b)(3)(A)(ii).

⁵ 17 CFR 240.19b-4(f)(2).

⁶ See Securities Exchange Act Release No. 49922 (June 28, 2004), 69 FR 40701 (July 6, 2004)(SR-PCX-2004-51).